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Research Update:

Bahrain Telecommunications Co. 'BB+/B' Ratings Affirmed On Continued Very Low Leverage; Outlook Stable

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Overview

- We believe that Bahrain Telecommunications Co. (Batelco) now has a clearer acquisition strategy.
- However, we also take into account the weakening fiscal profile of Bahrain, Batelco's controlling shareholder.
- We are affirming our 'BB+/B' long- and short-term ratings on Batelco.
- The stable outlook reflects our view that Batelco will maintain its operating performance and that profitability will stabilize at the current levels. We assume that adjusted debt to EBITDA will not materially exceed 2.0x.

Rating Action

On June 29, 2015, Standard & Poor's Ratings Services affirmed its 'BB+/B' long- and short-term corporate credit ratings on Bahrain-based telecommunications incumbent Bahrain Telecommunications Co. (Batelco). The outlook remains stable.

At the same time, we also affirmed our 'BB+' issue ratings on the senior unsecured notes due 2020, issued by Batelco International Finance No.1.

Rationale

The affirmation reflects continued very low leverage at Batelco, as well as a positive evolution of our financial policy assessment for Batelco, combined with a negative evolution of our comparative rating analysis, based on the fiscal situation of Bahrain (BBB-/Negative/A-3), Batelco's controlling shareholder.

We believe that Batelco has a more clearly articulated acquisition strategy than previously. We do not expect major debt-financed acquisitions that would bring the company's net adjusted debt to EBITDA substantially beyond 2.0x (in first-quarter 2015, it was 0.6x). We have therefore revised our financial policy assessment to "neutral" from "negative."

At the same time, the fiscal profile of Bahrain is weakening, in our view. A one-notch lowering of the sovereign rating would result in a cap on Batelco's ratings at 'BB+', given the strong link between the company and the sovereign.

As a result, we have revised our comparative rating analysis modifier to "negative" from "neutral."

Constraining Batelco's business risk profile are its fairly small scale on a global basis, the evolving competitive and regulatory landscape for telecoms in Bahrain, and its exposure to country risk. Offsetting these weaknesses is Batelco's adequate competitive position in Bahrain's fixed-line and mobile telephony markets and high margins. The company dominates Bahrain's fixed-line market, whereas the mobile industry is competitive.

Batelco's financial risk profile is supported by its currently very low debt leverage and large cash balance. The weak fiscal position of Batelco's majority shareholder, Bahrain, leads us to expect a continued high dividend payout ratio.

Outlook

The stable outlook reflects our view that Batelco will maintain its operating performance and that profitability will stabilize at current levels. We assume that the company's adjusted debt to EBITDA will not substantially exceed 2.0x.

Downside scenario

We could lower the ratings if Batelco's adjusted debt to EBITDA materially exceeded 2x, or if it was substantially above 1.5x in combination with weak or negative free operating cash generation. This could result from a merger or acquisition, a weakening in operating performance (notably in the domestic market), or higher dividends.

Upside scenario

Rating upside is constrained by the fiscal pressure on Batelco's majority shareholder, Bahrain.

Ratings Score Snapshot

Corporate Credit Rating: BB+/Stable/B

Business risk: Fair

- Country risk: High
- Industry risk: Intermediate
- Competitive position: Fair

Financial risk: Modest

- Cash flow/Leverage: Modest

Anchor: bbb-

Modifiers

- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Adequate (no impact)
- Financial policy: Neutral (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Negative (-1 notch)

Stand-alone credit profile: bb+

- Sovereign rating: BBB-/Negative/A-3
- Likelihood of government support: Moderately high

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Telecommunications And Cable Industry, June 22, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios and Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Jurisdiction-Specific Adjustments To Recovery And Issue Ratings, June 20, 2008

Ratings List

Ratings Affirmed

Bahrain Telecommunications Co.

Corporate Credit Rating BB+/Stable/B

Batelco International Finance No. 1 Ltd.

Senior Unsecured* BB+

*Guaranteed by Bahrain Telecommunications Co.

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